



USDA Foreign Agricultural Service

GAIN Report

Global Agriculture Information Network

Template Version 2.09

Voluntary Report – public distribution

Date: 7/27/2005

GAIN Report Number: PO5018

The Iberian Peninsula Drought

Agricultural Situation

Voluntary

2005

Approved by:

Stephen Hammond
U.S. Embassy

Prepared by:

Leonor Ramos
Pilar Munoz
Carlos McGrath

Report Highlights:

Iberian Peninsula (IP) wheat and coarse grains imports may reach a record 22 million metric tons (MMT) for marketing year (MY) 2005/06, six MMT more than our previous forecast in early May, and about eight MMT more than during MY 2004/05. The increasing import needs for wheat, coarse grains, non-grain feed ingredients, and for other non-irrigated, non-grain crops may provide opportunities in the IP market for U.S. exporters, and reduced competition for U.S. exports in third-country markets. (LR28CM45PM4SH24)

Includes PSD Changes: No
Includes Trade Matrix: No
Unscheduled Report
Madrid [SP1]
[PO]

TABLE OF CONTENTS

Executive Summary	3
Production, Supply and Distribution for Key Wheat and Coarse Grains	5
Wheat, Coarse Grains, and Non-Grain Feed Ingredients (NGFIs) Imports and Use..	6
Feed Wheat and Coarse Grains.....	6
Current Spanish Feed Wheat and Coarse Grain Prices.....	7
Durum and High-Quality Milling Wheat	7
NGFIs and Dehydrated Alfalfa	8
Special Drought Measures	8
Spain	8
The EC	8
Portugal.....	8
The EC	9
Drought Status	9
Areas Most Affected by the 2005 Drought (Water balance deficit on arable land)	10
Region.....	10
From the average.....	10
30 year comparison	10
Impact on Agricultural Sector	13
Spain	13
Portugal.....	14

Executive Summary

This is a follow-up to our previous drought reports SP5004 and SP5013.

Wheat and Coarse Grain Imports: The IP year-to-year increase in imports of feed wheat and coarse grains comes as a result of one of the driest years on record, devastating local dry-land production and increasing compound-feed demand, because of extremely poor pasture conditions. Compound feed demand is also buoyed by relatively low commodity prices resulting from bumper crops elsewhere in Europe. In addition, wheat and barley use in the production of ethanol will likely reach 1.5 MMT, double last year's use, adding to the need to import during this marketing year.

We expect that most coarse grain, feed wheat and non-grain feed ingredient imports will reach record levels.

Potential Import Records:

- Feed wheat imports will likely soar to about 12.5 MMT (approximately seven MMT in MY 2004/05). The UK and France will supply about half of the total, with Black Sea exporters filling the TRQ, with the rest coming from Germany, Hungary, and crop-harvest-dependent sources such as Finland, Canada, etc.
- Corn imports may reach 6 MMT (about five MMT in MY 2004/05), of which we expect France to have the highest percentage, with Argentina, Brazil, etc. filling the accession quota, and Hungary making its first major entry into the IP market assuming transportation assistance from the EC
- Barley imports could surpass two MMT (approximately one MMT in MY 2004/05) with all of it coming from France and Germany
- Other feed grain imports could surpass one MMT (about .8 MMT in MY 2004/05)
- Note: Spain makes up about 80 percent of the import activity—Portugal 20 percent.

While we expect record corn imports, we are watching very closely the debate between Monsanto and the Argentine Government regarding the export of Argentine corn containing Monsanto biotechnology. If this problem isn't resolved soon, it could spill over into the IP market, and could certainly alter the origin of corn imports, if not the relative levels of each grain imported.

Our forecast includes the potential use of about 1.5 MMT of feed-wheat and barley (Please see SP 5019 for additional details on barley and feed wheat use in ethanol production) in the production of ethanol (up from about .7 MMT during MY 2004/05). We include an additional line in the tables below to accommodate the barely and feed-wheat use in ethanol. And while we forecast record barley imports, we are also forecasting record-low barley use in feed rations (explanation later in the report).

IP importers of high-quality and durum wheat will also be active this marketing year. As evidence, the Australian Wheat Board (AWB) recently sold 50,000 metric tons (MT) of durum into the Spanish market. This was the first such sale in many years. U.S. exporters will likely share in the increased IP demand, but will face the usual quality/price advantages provided by single desk sellers such as the AWB.

Wheat and Coarse Grain Exports: IP wheat and grain exports will be at record-low levels and will likely be limited to close-proximity border trade.

Production—All Crops: Domestic dry-land production (of all dry-land crops) was devastated this year, while some irrigated crops are doing extremely well. We expect dry-land wheat, grain, sunflower, almond, olive, apple, citrus, etc. production to be off by as much as 60 percent. We will reflect these realities in upcoming Tree Nuts, Fresh Deciduous Fruit, Canned Fruit and Citrus Fruit reports. However, where these and other crops are irrigated, they have progressed very well this year. As an example, some irrigated corn production could reach record per hectare yields, even though total production will be off from record levels, because fewer hectares and less productive varieties were planted in response to the drought.

Potential (lowest) production records since the end of the last drought cycle 1990-1995:

- Wheat production at three MMT during MY 2005/06 (over seven MMT last year)
- Barley production during MY 2005/06 at five MMT down from ten MMT last year
- Oat production at .5 MMT during MY 2005/06, half last year's production

The Drought: If the drought progresses, as some experts believe it will (please see our drought section below), next year's dry-land and irrigated crops could again be at very low yields. Soil moisture and reservoir levels are now extremely low. Watch for further developments.

Government Response: Local and national Governments, and the European Commission (EC) are attempting to mitigate the economic difficulties created by the drought. The EC has authorized a number of extraordinary measures, as have local and national governments (Please see below). This drought could also propel the EC and Member States to consider new (or old) risk management tools such as insurance, stabilization funds, and income support mechanisms.

Production, Supply and Distribution for Key Wheat and Coarse Grains

IP Wheat

July/June Marketing Year

	00/01	01/02	02/03	03/04	04/05	05/06
Area Harvested	2,579	2,361	2,636	2,395	2,341	2,329
Beginning Stocks	696	600	593	654	329	1,120
Production	7,649	5,162	7,235	6,180	7,359	3,100
MY Imports	4,221	6,628	7,065	4,613	6,900	12,500
MY Imports from US	52	685	207	605	460	800
TOTAL SUPPLY	12,566	12,390	14,893	11,447	14,588	16,720
MY Exports	835	1,003	1,595	838	485	410
Feed Consumption	5,354	5,037	7,022	4,850	7,245	9,838
Ethanol Production					300	600
Food Use Dom Use	5,777	5,757	5,622	5,430	5,438	5,400
Total Consumption	11,131	10,794	12,644	10,280	12,983	15,838
Ending Stocks	600	593	654	329	1,120	472
TOTAL DISTRIBUTION	12,566	12,390	14,893	11,447	14,588	16,720

IP Corn

July/June Marketing Year

	00/01	01/02	02/03	03/04	04/05	05/06
Area Harvested	585	668	605	616	614	550
Beginning Stocks	601	650	481	420	395	946
Production	4,865	5,887	5,220	5,151	5,561	4,600
MY Imports	4,415	4,205	4,459	4,587	4,900	6,000
MY Imports from US	4	3	3	3	6	6
TOTAL SUPPLY	9,881	10,742	10,160	10,158	10,856	11,546
MY Exports	113	151	111	201	190	110
Feed Consumption	7,688	8,680	8,209	8,142	8,300	9,223
Food Use Dom Use	1,430	1,430	1,420	1,420	1,420	1,420
Total Consumption	9,118	10,110	9,629	9,562	9,720	10,643
Ending Stocks	650	481	420	395	946	793
TOTAL DISTRIBUTION	9,881	10,742	10,160	10,158	10,856	11,546

IP Barley

July/June Marketing Year

	00/01	01/02	02/03	03/04	04/05	05/06
Area Harvested	3,300	3,004	3,113	3,122	3,183	3,218
Beginning Stocks	214	707	220	212	63	970
Production	11,099	6,262	8,382	8,707	10,627	5,000
MY Imports	301	2,112	1,197	1,304	1,170	2,300
MY Imports from US	39	0	0	0	0	0
TOTAL SUPPLY	11,614	9,081	9,799	10,223	11,860	8,270
MY Exports	328	93	104	135	125	80
Feed Consumption	8,709	6,900	7,623	8,165	8,510	5,378
Ethanol Production					400	900
Food Use Dom Use	1,870	1,868	1,860	1,860	1,855	1,855
Total Consumption	10,579	8,768	9,483	10,025	10,765	8,133
Ending Stocks	707	220	212	63	970	57
TOTAL DISTRIBUTION	11,614	9,081	9,799	10,223	11,860	8,270

For all tables--FAS/Iberia estimates for MY 2005/06

*05/06 corn harvest is October 2005

Wheat, Coarse Grains, and Non-Grain Feed Ingredients (NGFIs) Imports and Use**Feed Wheat and Coarse Grains**

Member States, given the mounting EU 25 MY 2005/06 feed wheat, barley, and corn surpluses, will supply most of the increasing IP feed-grain demand. The U.K., France, Germany, and Hungary will likely supply most of the feed wheat used in the IP during MY 2005/06. Trade sources report that French feed wheat exportable surplus this year will be substantial, because the northern France wheat crop appears to have a very low specific weight. France and Germany appear to be harvesting large, low-quality barley crops that will have to be used for feed consumption, and France and Hungary appear to be building bumper corn supplies.

The United States and Black Sea countries are also not likely to profit (more than normal) directly from the IP MY 2005/06 feed grain deficit, because U.S. feed corn remains blocked from the market, and because of high, over-quota tariffs for Black Sea exporters.

However, the drought has created a home for exportable wheat and coarse grain surpluses within Europe that would have otherwise been exported, most with subsidy, onto the world market. As a result, the increasing IP import needs will ultimately benefit U.S. exporters.

If the current commodity price relationships and freight rates prevail during MY 2005/06, IP feed wheat use should expand more than corn or barley.

Current Spanish Feed Wheat and Coarse Grain Prices

		€ per MT					
Port of Entry		Wheat					
HUELVA/CADIZ	Jul/Aug	132/133	Sep/Dec	134			
CARTAGENA	Jul/Aug	131/132	Sep/Dec	132/133			
VALENCIA	Jul/Aug	133	Sep/Dec	136			
TARRAGONA	Jul/Aug	128/130	Sep/Dec	130/132	Jan/May	134	
BILBAO	Jul/Aug	126/128	Sep/Dec	130/132			
SANTANDER	Jul/Aug	126/128	Sep/Dec	130/132	Jan/May	132/134	
ASTURIAS	Jul/Sep	130/132	Oct/Nov	134	Dec/Jan	136	
GALICIA	Jul	126	Aug	127/128	Sep/Dec	130/132	Jan/May 134
Port of Entry		Available		Barley			
HUELVA/CADIZ	139	Jul/Aug	139	Sep/Dec	139		
CARTAGENA		Jul/Aug	135	Sep/Dec	138		
VALENCIA	141	Jul/Sep	141	Oct/Dec	142		
TARRAGONA	135	Jul/Aug	137/139	Sep/Dec	137/139		
BILBAO	128	Jul/Aug	128/130	Sep/Dec	133/135		
SANTANDER	128	Jul/Aug	128/130	Sep/Dec	133/134		
ASTURIAS		Jul/Aug	130	Sep/Dec	134/135		
GALICIA	127/128	Jul/Aug	128/130	Sep/Dec	133/134		
Port of Entry		Available		Corn			
HUELVA/CADIZ		Jul/Sep	144	Oct/Dec	144/146		
CARTAGENA		Jul/Sep	146	Oct/Dec	142/143		
VALENCIA		Jul/Sep	147	Oct/Dec	142		
TARRAGONA		Jul/Sep	146/148	Oct/Dec	149		
BILBAO		Jul/Sep	148	Oct/Dec	141/142		
SANTANDER		Jul/Sep	148	Oct/Dec	141/142		
ASTURIAS		Jul/Sep	147/148	Oct/Dec	142/143		
GALICIA		Jul/Sep	147/148	Oct/Dec	141/142		

Source: CESFAC

Barley imports will likely be up from previous years but will be constrained by the CIF cost-feed-value relationship. France and Germany appear to be in position to export to IP feed compounders, but the quality of the barley relative to current pricing will keep local compounders adjusting their formulas in favor of feed wheat and corn.

Even though we are forecasting record barley imports, with reduced domestic production and increasing barley use in ethanol production, we are forecasting that barley use by compounders will be at record low levels during MY 2005/06. Barley is needed for certain compound feeds, but beyond that limited production, the formulas are readily adjustable.

Durum and High-Quality Milling Wheat

Most of the additional IP high-quality milling wheat needs will likely originate in France, Germany, with North American filling in the quality gap. Demand for non-EU high-quality wheat will be determined by the quantity and quality of the German crop, a factor still undetermined at this time. Of the remaining import needs, the U.S. NS/DNS wheat competes with Canadian spring wheat, but trade sources report that Canadian wheat often times gets the nod, because it is supplied at above-contract quality but at contract-quality

prices. So, while we expect additional U.S. exports, they certainly will depend to some extent on the quantity and quality of the U.S. and Canadian crops and the aggressiveness of Canada's single desk seller.

The AWB has just reported the sale of 50,000 MT of Australian durum to Spain, the first Australian wheat export into the IP in many years. This certainly is an indication of the state of play for durum wheat, which previously has been in exportable surplus in Spain.

NGFIs and Dehydrated Alfalfa

None grain feed ingredients will also play an important role in this year's compound-feed ingredient imports. Manioc, distillers grains, dehydrated alfalfa, corn gluten feed, peas, beans, etc. are important feed ingredients and will be used/imported when and where cost effective. Local compounders are very flexible in their potential for feed ingredient use.

However, some dehydrated alfalfa will have to be replaced in the traditional feed mix, because of a more drought-reduced local supply, and may, in fact be very difficult to replace. For the first time in recent history, we have received requests for information regarding the potential for exportable surpluses from the United States.

Special Drought Measures

Spain

As a result of pressure from local cooperatives, the Government of Spain addressed the drought in a major way publishing Royal Decree 10/2005. It contains special tax breaks, including exemption from payments of social security, funds for the construction of livestock drinking water structures, and additional credit to severely affected farmers, all with an initial ceiling of 750 million euros. Many of these measures are joint ventures with the local autonomous governments, each picking up part of the tab.

The EC

On July 28, 2005, the EC adopted a series of measures to mitigate the effects of the drought on the IP. It authorized the Government of Spain (GOS) to advance payments on 2005 arable land aid, as well as permission to use the vegetation on set-aside land for feed in nine of the most harshly affected regions of the country (a step already granted to Portugal in April—Please see SP 5013). The EC also lifted sheep and goat retention periods allowing farmers to sell their animals before August 15, and still qualify for coupled ewe premium. The EC permitted Spanish traders to import up to 500,000 tons of grains from E.U. intervention stocks, including 100,000 tons of barley, 100,000 tons of corn and 200,000 tons of wheat from Hungary, and 100,000 tons of Slovak corn. The EC approved the first sales of intervention stocks on July 28: 41,406 tons of corn from Hungary, and 2,905 tons of barley from Germany.

Portugal

Earlier emergency measures described in PO 5003 and PO 5008 have been complemented by a series of EC decisions on July 29. The measures included an EC authorization for Portugal to advance 50 percent of 2005 sheep subsidies, and 80 percent of breeding cow premium (an increase over the 60 percent previously allowed) as of October 16, 2005. There is also scope for payment of 50 percent of the 2005 decoupled Single Farm Payment (SFP) providing some conditions are satisfied.

The GOP may also decide to use the "de minimis" regulation that allows them to grant aid of € 3,000 per farmer over a three-year period without consulting the EC—not to exceed € 17,832 over the period. So far, the GOP has declined to implement this measure.

The EC

The EC provided a framework through state aid for the GOP to compensate farmers hurt by the drought. However, the EC will grant permission on a project-by-project basis once they have reviewed proposals submitted by the GOP. So far, the GOP has put forward two proposals; one to assist with providing water for livestock, and a second for a credit line to mitigate the increased cost of feeding livestock.

On June 15, 2005, the EC made available 200,000 tons of Hungarian intervention grains through EC Reg. 923/2005. Thus 80,000 ton of corn, 80,000 ton of wheat and 40,000 ton of barley from intervention stocks were made available for purchase by the Portuguese intervention agency (INGA) at the intervention price of €101.31 per MT. INGA will manage the grains re-sale in the domestic market. The EC will subsidize transportation costs not to exceed € 60 per MT.

INGA has not yet implemented the purchase, because the GOP has not yet promulgated appropriate domestic regulation. Once completed, the GOP will request bids for grain transportation, discharge, and storage. INGA will sell the intervention grains to producer organizations such as cooperatives, or feed compounders with contracts with these organizations. Re-sale of the intervention stocks will not be permitted. Local trade sources expect that the intervention grains will dampen local grain prices until the market has cleared the additional grains.

A second tranche of 200,000 tons from intervention stocks may be made available pending favorable EC assessment of results from the initial tranche.

Drought Status

The IP is experiencing the driest period in 60 years; possibly indicating the start of a drought cycle that could last five years or more if historical precedent prevails. The last drought cycles to hit the Iberian Peninsula were in 1990-1995 and 1979-1982.

In Spain, rainfall between October, 2004, and June, 2005, was two-thirds the average since officials began tracking such information in 1930, and about 20 percent less than during the same period during the last drought cycle.

Similarly in Portugal, the drought has been severe. Since July and August are normally dry months, concerned officials don't have prospects of rains returning before September.

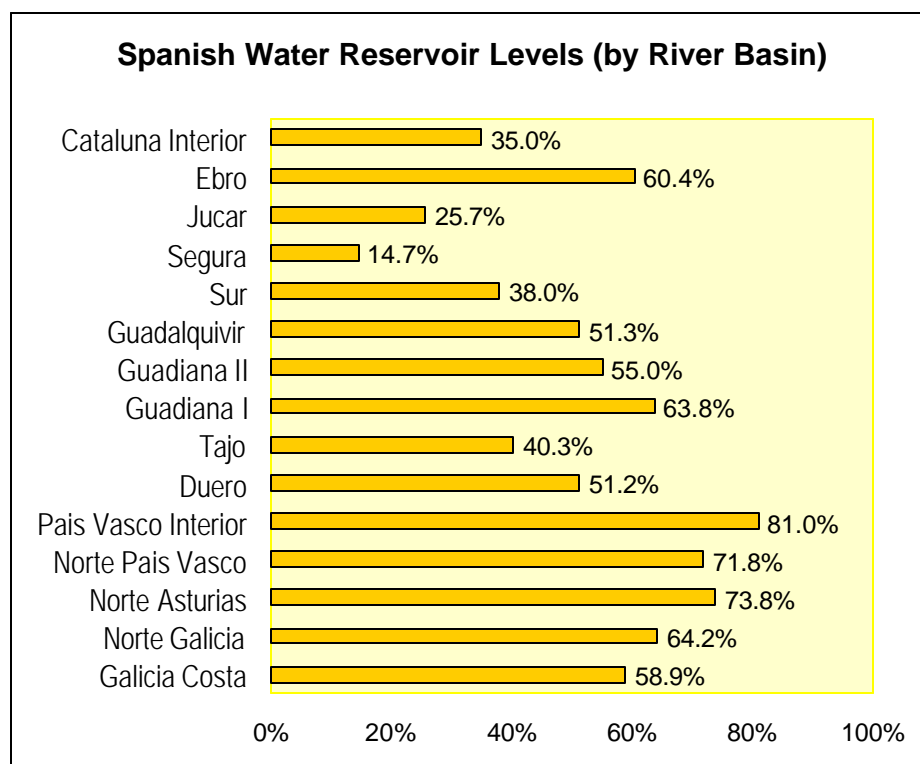
Areas Most Affected by the 2005 Drought (Water balance deficit on arable land)

Region	From the average	30 year comparison
All of Spain	(- 170 mm)	Most severe
Northeast	(- 140 mm)	Most severe
Madrid	(- 200 mm)	Most severe
Central region - Castilla y Leon	(- 220 mm)	Most severe
Central region - Castilla la Mancha	(- 210 mm)	Most severe
Central region- Extremadura	(- 220 mm)	Most severe
East	(- 170 mm)	4th worst year
Catalalonia region	(- 160 mm)	4th worst year
Valencia	(- 160 mm)	3rd worst year
South—Andalucia region	(- 160 mm)	2nd worst year
All of Portugal	(- 280 mm)	Most severe
North	(- 340 mm)	Most severe
Central	(- 340 mm)	Most severe
Lisbon region	(- 310 mm)	Most severe
South Center	(- 250 mm)	Most severe
South- -Algarve	(- 260 mm)	Most severe

Source: **European Commission's Directorate General Joint Research Centre and FAS/Iberia**

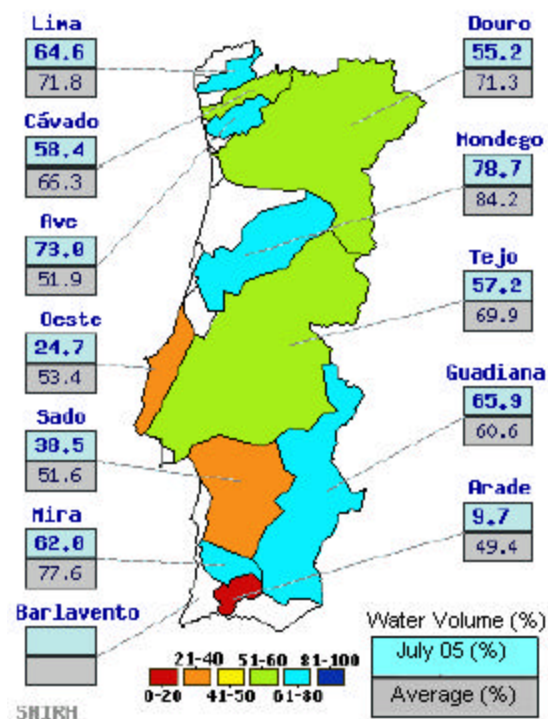
Spanish reservoirs are at about 50 percent of their capacity, and have been decreasing at an average rate of about 1.3 percent per week. At the Segura reservoir, the level has been so low (the worst in Spain) that the Segura Hydrographic Confederation has announced that they will use 54 wells for irrigation in order to alleviate the effects of the drought in that region.

If the drought persists next year, and these reserves are not replenished, both dry-land and irrigated crops will register below average yields. IP import needs then will continue to increase.



Source: Spanish Ministry of Environment

Portuguese Water Reservoir Levels



Source: Portuguese Water Institute

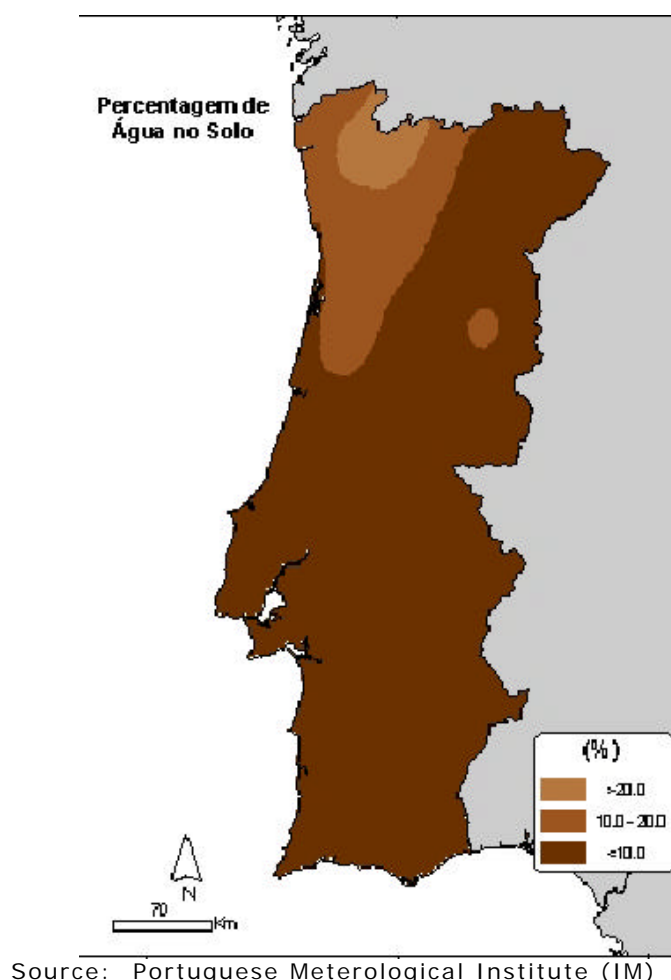
The Portuguese Drought Commission, which, for the first time, rated a drought cycle as either extreme or severe, has been following the drought closely, producing detailed reports every 15 days. Soil moisture levels in Spain and Portugal have been very low because of hot and dry conditions, with Portugal's total soil moisture averaging at around 10 percent. Some areas are at risk of desertification.

Percentage of Territory Affected by the Drought

Drought Severity	Percentage of Territory	
	July 15	June 30
Weak	0	0
Moderate	0	3
Severe	20	33
Extreme	80	64

Source: Portuguese Drought Commission

Portugal: Water Percentage in Soil on July 15



Impact on Agricultural Sector

Below we provide some details on drought-induced losses for this year from reports we obtained from local Government and producer sources. For production data for key commodities, please check Production, Supply & Distribution table section at the beginning of this report.

Spain

Producer sources estimate total farmer losses due to the drought at 3,882.4 Million euros. For loss outbreak by crop, please check Table below:

Spain: Summary of Losses Due to the Drought

Crop:	Losses (Million Euros)
Winter Grains	2,988
Summer Grains	819
Sunflower	37.7
Beets	13.5
Other	24.2
Total	3,882.4

Source: UPA

Portugal

Local producer sources claim that the drought caused some Million € 2,000 in losses due to the reduced crop yields, and to the problems derived from shortage of drinking water. In addition to this, farmers report further losses related to the high incidence of forest fires in drought condition, which have destroyed considerable cork and elm oak forest areas. Below we provide a summary table with the yield variation of key crops, as reported by the National Statistics Office (INE):

Portugal: Productivity Variations in 2005

Crops:	2000/04 Average = 100 (%)	2004 = 100 (%)
<u>CEREALS</u>		
Durum Wheat	30	30
Soft Wheat	35	35
Triticale	26	30
Rye	75	70
Oats	34	35
Barley	36	35
Rice	99	100
Un-irrigated corn	82	85
<u>POTATOES</u>		
Un-irrigated potatoes	79	75
Irrigated potatoes	95	95
<u>PROCESSING CROPS</u>		
Tomato	106	100
Sunflower seeds	64	70
<u>FRESH FRUIT</u>		
Peaches	108	100
Apples	104	100
Pears	105	80
Table Grapes	99	100

Source: National Statistics Office (INE)